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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
1995 Annual Access Tariffs	)	CC Docket No. 96-5
	)	
GTE Telephone Operating Companies	)	Transmittal No. 963
GTE System Telephone Companies	)	Transmittal No. 146

REPLY COMMENTS OF U S WEST COMMUNICATIONS, INC.

In its previous comments on the GTE Telephone Operating Companies' and GTE System Telephone Companies' (collectively "GTE") Direct Case,[1] U S WEST Communications, Inc. ("U S WEST") supported the methodology it developed for exogenous adjustment and cost assignment associated with a price cap carrier's sale of exchanges.[2] AT&T Corp. (or "AT&T") also filed comments which supported the use of the U S WEST methodology by GTE.[3] In its comments, however, AT&T concludes that previous Federal Communications Commission ("Commission") Orders make it clear that only exogenous adjustments which result in reductions to a local exchange carrier's ("LEC") price cap indexes ("PCI") are appropriate in the

[1] In the Matter of 1995 Annual Access Tariffs, GTE Telephone Operating Companies, GTE System Telephone Companies, CC Docket No. 96-5, Transmittal Nos. 963 and 146, Order Designating Issues for Investigation, DA 96-54, rel. Jan. 23, 1996 ("Designation Order").

[2] U S WEST Comments on Direct Case, filed herein Mar. 5, 1996.

[3] AT&T Corp.'s Comments on GTE's Direct Case, filed herein Mar. 5, 1996 at 1.

case of exchange sales.[4] AT&T's improper conclusion is neither supported by the Commission's previous Orders nor is it reasonable to impose such an unreasonable condition on such adjustments. The Commission must allow for exogenous adjustments which reflect both upward and downward cost changes resulting from exchange sales by price cap LECs.

As noted by AT&T, and relevant to the Direct Case, GTE has recently sold several telephone exchange properties across its serving territory.[5] In most of these cases, the exchanges sold had costs which exceeded the average of other exchanges owned and operated by GTE ("high-cost exchanges"). In a few cases, the exchanges sold had costs which were below GTE's average costs ("low-cost exchanges"). AT&T argues that previous Commission Orders require that GTE make an exogenous adjustment to its PCIs which reflects the impact of the exchange sales.[6] U S WEST agrees that the Commission previously ordered such exogenous treatment for exchange sales in its First Report and Order.[7] AT&T further argues that "[i]t is clear from the Commission's discussion of exogenous cost adjustments from the sale of telephone exchanges that only exogenous cost reductions will be considered."[8] Thus, AT&T would effectively exclude any exogenous cost adjustments from

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[4] Id. at 7.

[5] Id. at 3.

[6] Id. at 2.

[7] In the Matter of Price Cap Performance Review for Local Exchange Carriers, First Report and Order, 10 FCC Rcd. 8962, 9104-05 ¶ 328 (1995) ("First Report and Order").

[8] AT&T at 7 (emphasis added).

exchange sales which would require an exogenous cost increase, as would be the case of GTE's sale of several low-cost exchanges. U S WEST fervently disagrees with AT&T's erroneous conclusion that only exogenous cost reductions are appropriate. Such a condition on exogenous adjustments was never addressed by the Commission in its First Report and Order and, in fact, would be contrary to previous Commission Orders which specifically allowed both upward and downward exogenous adjustments. Such a condition would also be contrary to proper public policy considerations and the public interest.

In the First Report and Order, the Commission found that "sales or swaps of exchanges should result in an exogenous adjustment to the price cap carrier's PCI."[9] The Commission recognized that such exogenous treatment was a "limited departure from [its] general standard for determining exogenous cost changes -- costs incurred by LECs as a result of administrative, legislative or judicial requirements beyond the control of the carriers and not otherwise reflected in GDP-PI."[10] The Commission went on to state, however, that "[it] believe[s] that this departure is necessary to maintain consistency with the concept of the price cap plan overall."[11] Contrary to AT&T's conclusion, it is not "clear" that the Commission intended to limit exogenous adjustments from exchange sales to only those which

[9] First Report and Order, 10 FCC Rcd. at 9104-05 ¶ 328.

[10] Id.

[11] Id.

were downward. In fact, the Commission's language supports just the opposite conclusion.

For exogenous treatment for exchange sales to maintain "consistency" with the price cap plan overall, both upward and downward exogenous adjustments must be available. Since the beginning of price cap regulation, the Commission has consistently considered exogenous factors which would result in both upward and downward exogenous cost adjustments.[12] The Commission has never held that only exogenous changes which result in downward adjustments are appropriate. And, while the Commission's specific intent in the First Report and Order may have been to remove the perverse incentives for price cap LECs to "game the system" and realize "windfall profits" by selling off high-cost exchanges, the Commission never specifically addressed or discussed exogenous adjustments as they potentially related to the sale of low-cost exchanges. AT&T's conclusion is neither supported by the Commission's language nor consistent with prior Commission decisions.

Such a conclusion is also contradictory to the Commission's previous finding, cited by AT&T, that exogenous changes are necessary to ensure that price cap

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[12] See, e.g., In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd. 2873, 3005-18 ¶¶ 259-95 (1989) where the Commission considered the following for exogenous treatment: changes in costs due to tax law changes; changes in the rate of flow-back of excess deferred taxes; changes in expense levels due to the expiration of current amortization programs; changes due to amendments to Part 36 of the Commission's rules; the Jurisdictional Separations Manual; changes due to amendments to Part 32 of the Commission's rules; and the Uniform System of Accounts.

regulation does not lead to "unreasonably high or unreasonably low rates."[13] Limiting exogenous cost adjustments for exchange sales to only those that produced a downward PCI adjustment would unquestionably result in rates which were "unreasonably low," and such a result is clearly contrary to the Commission's previously stated goals for price cap regulation.

Limiting exogenous treatment to only those cost changes which produce downward PCI adjustments is also an unreasonable and improper restraint of free trade and is contrary to the public interest. AT&T's limitation on upward exogenous cost adjustments related to exchange sales would place an inappropriate and improper restraint on future LEC exchange sales. Such a limitation would drastically discourage the sale of low-cost or highly-profitable exchanges as, without a concomitant exogenous adjustment to PCIs, the price levels in the remaining unsold exchanges would be unreasonably low. The Commission would effectively "tie the hands" of the LECs by keeping them locked into their existing serving areas. This precludes the LECs from making sales or swaps which might increase their overall efficiencies.[14] It also precludes other potential parties in the telecommunications marketplace from acquiring profitable LEC exchanges as a competitive entry strategy.

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[13] AT&T at n.3 citing In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd. 6786, 6807 ¶ 166 (1990) ("LEC Price Cap Order"), modified on recon., 6 FCC Rcd. 2637 (1991).

[14] This is contrary to previous Commission statements encouraging LECs to become more efficient and innovative in their provision of services. See First Report and Order, 10 FCC Rcd. at 9104 ¶ 328 citing the LEC Price Cap Order, 5 FCC Rcd. at 6790 ¶ 31.

In the future, U S WEST believes that the concept of "exogenous symmetry" should apply to exchange sales for price cap LECs. Exogenous cost adjustment should be fair, equitable, and not serve to encourage irrational behavior or discourage rational behavior. U S WEST would propose that the exogenous cost adjustment for LECs selling exchanges be equal to revenue less costs. The sale of a high-cost exchange would generate a downward exogenous cost adjustment, and the sale of a low-cost exchange would generate an upward exogenous cost adjustment. The purchasers of those exchanges should also be subject to symmetrical exogenous treatment, i.e., the buyer of a low-cost exchange would have a downward adjustment, and the buyer of a high-cost exchange would have an upward adjustment. Symmetrical exogenous treatment will not discourage the sale of lower-cost exchanges in situations in which such a sale would result in greater efficiency. Such treatment also serves to protect an access customer, such as AT&T, from a buyer of low-cost exchanges not making an exogenous adjustment to reflect a lower overall average cost of providing service. As can be seen from this example, asymmetric exogenous cost rules do not necessarily protect customers from the potential for paying unreasonably high rates.

As demonstrated above, AT&T's assertion that only exogenous cost reductions resulting from the sale of exchanges are appropriate is clearly unsupported by previous Commission decisions and proper public policy considerations. The Commission must find that both upward and downward exogenous adjustments are appropriate when considering the impact of exchange sales by price cap LECs. Based upon the foregoing, the Commission should rule accordingly regarding GTE's Direct Case.

Respectfully submitted,

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March 19, 1996

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 19th day of March, 1996, I have caused a copy of the foregoing **REPLY COMMENTS OF U S WEST COMMUNICATIONS, INC.** to be served via first-class U.S. Mail, postage prepaid, upon the persons listed on the attached service list.

Kelseau Powe, Jr.

Kelseau Powe, Jr.

***Via Hand-Delivery**

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